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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 41

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

NATIONAL SECURITIES, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The opinion of the district court (App. 139–144) is reported at 252 F. Supp. 623. The opinion of the court of appeals (App. 148–161) is reported at 387 F. 2d 25.

JURISDICTION

The judgment of the court of appeals was entered on November 14, 1967 (App. 162). On February 10, 1968, Mr. Justice Douglas extended the time for filing a petition for a writ of certiorari to and including March 4, 1968. The petition was filed on the latter date, and was granted on April 22, 1968 (App. 163). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the McCarran-Ferguson Act—Section 2(b) of which provides that no act of Congress shall "invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to" that business—precludes the application of the antifraud provisions of the Securities Exchange Act of 1934 to false and misleading statements made in soliciting stockholder consents to a merger of insurance companies.

STATUTES AND RULE INVOLVED

The relevant provisions of the McCarran-Ferguson Act, 59 Stat. 33–34, 15 U.S.C. 1011–1015, Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), and Rule 10b–5 of the Securities and Exchange Commission, 17 CFR 240.10b–5, are set forth in the Appendix, *infra*, pp. 33–35.

STATEMENT

The Securities and Exchange Commission instituted this action in the United States District Court for the District of Arizona in March 1965, to enjoin respondents National Securities, Inc., its subsidiary National Life and Casualty Insurance Company, and certain officers and employees of one or both of these companies from violating Section 10(b) of the Securities Exchange Act of 1934 and the Commission's Rule 10b–5 thereunder (App. 11–24), which generally prohibit fraud in connection with the purchase or sale

of securities.[1] The district court dismissed the suit on the pleadings (App. 145), and the court of appeals affirmed on the ground that the action was barred by the McCarran-Ferguson Act, Section 2(b) of which provides (App., *infra*, p. 33):

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance * * *.

1. The Commission's amended complaint made the following allegations—which the court of appeals stated "must be presumed by us to be true" (App. 154):

National Securities is a holding company which owned two-thirds of the 1,018,574 outstanding shares of National Life, an insurance company incorporated in Arizona. Producers Life Insurance Company, another insurance company incorporated in that State, had 881,976 outstanding shares of common stock, held by approximately 14,000 stockholders in many States. The defendants formed an illegal scheme, in violation

[1] Section 10(b) makes it unlawful to use, in connection with the purchase or sale of any security in interstate commerce or through the mails, "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules. Rule 10b-5 makes it unlawful, in connection with such purchase or sale, "to employ any device, scheme, or artifice to defraud," to make "any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made * * * not misleading," or to engage "in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." App., *infra*, p. 34.

of the antifraud provisions of the Act, by which (a) National Securities would acquire control of Producers Life, (b) National Life and Producers Life would be consolidated,[3] and (c) the consolidated company would pay a large part of National Securities' cost of acquiring control of Producers Life (App. 82–86).

As a step in obtaining control of Producers Life, National Securities purchased the stock of that company held by four of Producers Life's directors, and agreed to pay them large sums in return for their agreement not to compete with Producers Life or any successor company. At the same time National Securities purchased from Producers Life more than 50,000 shares of its treasury stock, and assumed liabilities of Producers Life of some $600,000 stemming from prior agreements of other persons not to compete with it (App. 85–86).[4] National Securities did not

[3] Under the terms of the consolidation agreement, each stockholder of Producers Life was to receive an additional share of Producers Life stock for every five shares owned. The ratification by the stockholders of Producers Life of the issuing of this stock was made a condition precedent to the consolidation agreement. The agreement further provided that each shareholder of National Life would receive one share of Producers Life stock for each share of National Life owned by him. The consolidation agreement, in addition, provided that the consolidated company would be known as National Producers Life Insurance Company. Although the shareholders of Producers Life did not actually surrender their certificates, upon the execution of the consolidation agreement (pursuant to ratification by them) their interests and rights were materially changed (App. 85).

[4] National Securities purchased 50,208 shares of treasury stock for $9.59 per share, and also assumed liabilities payable over approximately eight years of $637,801. National Securities'

disclose to Producers Life or its stockholders that it intended to impose these liabilities upon the corporation that would result from the planned consolidation of Producers Life and National Life (App. 90–91).

After obtaining control of Producers Life, National Securities caused the latter to mail to its stockholders material soliciting them to approve the proposed consolidation with National Life. This material was false and misleading because, among other things:

a. It did not disclose the amount of National Securities' liability on the agreements not to compete—more than $1,400,000—which was to become a continuing charge against the income of the consolidated company (App. 90–91).

b. It repeatedly predicted that the consolidated company would have net earnings of more than $460,000 annually, but did not disclose that Producers Life and National Life had had losses in the prior year (1964) of approximately $70,000 and $35,000, respectively (App. 47, 94, 95–96, 117, 119, 122, 124, 127, 129).

c. It set forth in the pro-forma balance sheet for the consolidated company an asset shown as "Treasury Stock $1,174,556" that was "illusory" (App. 51, 93–94).

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simultaneous purchase of 27,416 shares of Producers Life from four of the latter's directors was at $20.79 per share, and its purchase from a company controlled by the same directors of 38,894 shares of Producers Life was at $9.50 per share. In addition, the four directors were to be paid $979,000 over the next ten-year period for their agreements not to compete (App. 85–86).

d. It did not disclose that in its 1964 Annual Report to the Arizona Insurance Commission, National Life had written down on its books the value of its stockholdings in Producers Life from $1,164,000 to $641,658 (App. 96, 130, 131, 133).

2. Upon the filing of the Commission's action, the district court entered a preliminary restraining order which, as subsequently modified, barred the defendants generally from violating the antifraud provisions of the Act, but permitted them to submit the consolidation plan to the stockholders for approval (App. 96–97). The stockholders accepted the plan, the Arizona Insurance Commissioner approved it and the defendants effected the consolidation (App. 96–98). The Commission then filed an amended and supplemental complaint in which it requested broader relief than it originally had sought (App. 98–100).[4]

[4] In addition to the injunction previously sought, the Commission requested that the defendants be required "to take all actions and measures which are necessary to rectify and correct the consequences of the[ir] wrongful and unlawful conduct * * * and to restore Producers Life, National Life, their stockholders and the defendants to the status and economic conditions which they occupied prior to April 27, 1964 [the date of the alleged agreement between National Securities, Producers Life and the four selling directors thereof]"; that the defendants "make an accounting of the extent to which their [illegal] actions and the [illegal] actions of the selling directors * * * have resulted in damage to such stockholders, and the extent to which the defendants have been unjustly enriched at the expense of such stockholders"; and that "by suitable decree of the Court, the respective equities of the defendants and the stockholders of Producers Life be arranged and adjusted on a fair and equitable basis, including, if warranted on the basis of the accountings made by the defendants, the subordination of the stock interests and other equities of Na-

In granting the defendants' motion for judgment on the pleadings, the district court held (1) that the McCarran-Ferguson Act precluded the "requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance" (App. 143); and (2) that the Commission's request for "an accounting for unjust enrichment, and other relief * * * would be inappropriate * * * and would, in all events, fall outside the scope of available relief provided in § 21(e) of the 1934 Act" (App. 144).[5]

The court of appeals affirmed on the ground that the McCarran-Ferguson Act barred the action, and did not pass upon the propriety of the relief that the Commission sought. The court stated that in the McCarran-Ferguson Act Congress "define[d] an exemption for insurance conterminous with its power to regulate interstate commerce"; that the legislative history of that Act disclosed "a general intention to set the insurance business outside the scope of all existing and future legislation regulating interstate commerce, without any more direct evidence that Congress had in mind the Securities Exchange Act"; that the provision in Section 4 of the McCarran-Ferguson

tional Securities in National Producers [the consolidated company] to the interests of those stockholders whose equities have been diminished by reason of the unlawful and wrongful conduct of the defendants" (App. 98-100).

[5] Section 21(e) authorizes the Commission to bring an action in the district court to "enjoin such acts or practices" as appear to the Commission to violate the Act or its rules thereunder, and provides that "upon a proper showing a permanent or temporary injunction or restraining order shall be granted * * *." 15 U.S.C. 78u(e).

Act making it inapplicable to the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act, 1920, indicated that Congress believed that, otherwise, the application of those statutes to the business of insurance would be suspended; that "the commerce clause was not to be used as a springboard for federal regulation in the absence of a specific statutory reference to insurance"; and that in the McCarran-Ferguson Act Congress wished "to preserve intact from any federal intrusion based on the commerce clause, existing and future State regulation of the insurance industry." (App. 156–157.) The court concluded its opinion with the statement that it was "in accord with" the following "views expressed by the district court":

> [T]he requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20–731, would at least "impair", if not "invalidate" or "supercede" (sic) laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act. [App. 161.]

SUMMARY OF ARGUMENT

Investors and prospective investors in securities of insurance companies have the same need for the protections of the federal securities laws as investors in other businesses. The holding of the court below that the McCarran-Ferguson Act deprives investors in insurance stocks of these protections creates a serious gap in the comprehensive scheme of securities regulation

that Congress designed to benefit the entire investing public.

The applicability of the federal securities laws to transactions in insurance company securities was firmly established long before the decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, to which the McCarran-Ferguson Act was directed. The application of those laws to such transactions has continued without abatement since the enactment of the McCarran-Ferguson Act, and thus has become a matter of settled administrative and industry practice. This regulatory jurisdiction was never dependent on whether transactions in insurance *policies* were considered to be interstate commerce subject to congressional regulation under the Commerce Clause; it was based instead on the proposition that the securities themselves were subjects of interstate commerce which Congress could regulate and on congressional power to regulate the use of the mails.

The legislative history of the McCarran-Ferguson Act makes clear that the Act's exclusive purpose was to counteract possible adverse effects that the decision in *South-Eastern Underwriters* might otherwise have had on the previously established power of the States to regulate and tax the business of insurance. Careful consideration of the Act as a whole demonstrates that it must be interpreted in light of, and restricted to, this legislative purpose in order to avoid unwarranted distortion of the intention of Congress. Because the previously established applicability of the federal securities laws to transactions in insurance company securities was entirely unaffected by the *South-*

Eastern Underwriters decision, it remains undiminished by the McCarran-Ferguson Act. This Court has implicity so held in decisions upholding the applicability of the federal securities laws to transactions in variable annuities, and Congress has explicitly indicated its understanding that these laws continue to apply to insurance company securities.

The 1964 amendments to the federal securities laws in no way diminished the applicability of those laws to transactions in insurance company securities. The insurance exemptions in those amendments are limited to requirements newly imposed by the amendments and are entirely consistent with a congressional purpose to preserve unimpaired the protections previously afforded investors in insurance company securities.

ARGUMENT

I

THE MC CARRAN-FERGUSON ACT DOES NOT IMMUNIZE TRANSACTIONS IN SECURITIES OF INSURANCE COMPANIES FROM THE APPLICATION OF THE FEDERAL SECURITIES LAWS

The court of appeals held, in effect, that the antifraud provisions of the Securities Exchange Act of 1934 were partially repealed by the McCarran-Ferguson Act. The court's reasoning would appear to be similarly applicable to other provisions of both the Securities Exchange Act and the Securities Act of 1933 (48 Stat. 74, 15 U.S.C. 77a *et seq.*). This holding creates a serious gap in the comprehensive investor protections that Congress provided in the federal securi-

ties laws and is, we submit, an erroneous interpretation of the McCarran-Ferguson Act.

In Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), Congress adopted a broad definition of "security" in order "to protect investors through the requirement of full disclosure by issuers of securities" (*Tcherepnin* v. *Knight*, 389 U.S. 332, 336). Section 10(b) of that Act makes it unlawful to use any manipulative or deceptive device or contrivance "in connection with the purchase or sale of *any* security registered on a national securities exchange or *any* security not so registered" (emphasis added). In the face of this clear congressional intent to extend the antifraud provisions to all sales and purchases of securities—and for many years the Commission has regarded an exchange of securities such as was involved in the consolidation of National Life and Producers Life as constituting a "purchase" or "sale" of securities under the antifraud provisions of the Securities Exchange Act of 1934 and the Securities Act of 1933[6]—an exception to the general broad scope of this important public legislation should not be created by implication unless it is clearly required by

[6] See Securities Act Release Nos. 3965 (1958), 4115 (1959). The courts of appeals for the Second and Seventh Circuits recently upheld the Commission's position on this question. *Vine* v. *Beneficial Finance Company*, 374 F. 2d 627 (C.A. 2), certiorari denied, 389 U.S. 970; *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262 (C.A. 7), certiorari denied *sub nom. Bard* v. *Dasho*, 389 U.S. 977. Twenty-five years ago the Ninth Circuit stated the contrary. *National Supply Co.* v. *Leland Stanford Junior University*, 134 F. 2d 689, certiorari denied, 320 U.S. 773.

some other federal statute. The McCarran-Ferguson Act, as we shall show below, was not intended to create such an exception.

The need to protect stockholders against such misrepresentations as were allegedly made in connection with the consolidation of National Life and Producers Life is no less compelling for investors in insurance companies than for investors in other businesses. The traditional thrust of State insurance regulation has been the protection of policy holders, not stockholders. Cf. *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Co., et al.*, 359 U.S. 65, 78-79 (concurring opinion of Mr. Justice Brennan). Even when State regulatory provisions may be broad enough to cover fraud in connection with transactions in securities of insurance companies, State experience and resources in the general area of stockholder protection tend to be both limited and divided between the officials administering the "blue sky" laws and those administering the insurance laws.[7] There is no assurance that the State authorities will apply the same comprehensive standards of fraud that have been developed under the federal securities acts, or will be able to give investors the same broad protection that the Securities and Exchange Commission can provide with its substantial staff and vast experience over many years in dealing with this frequently complex field. Indeed, in this very case the State insurance commissioner approved the merger under a statute which prohibits "untrue, deceptive or misleading" statements "with respect to the business

[7] See, generally, Loss and Cowett, *Blue Sky Law* (1958).

of insurance," [8] even though the Commission had submitted to him "all of the pleadings and evidentiary materials which had been before the Federal District Court" (Br. in Opp. 4), which alleged that seriously false and misleading information was being used in soliciting stockholders' consents to the merger.

A. THE FEDERAL SECURITIES LAWS HAVE CONTINUOUSLY BEEN APPLICABLE TO TRANSACTIONS IN SECURITIES OF INSURANCE COMPANIES

The issuer of securities need not be engaged in interstate commerce in order for the federal securities laws to be applicable to transactions in the securities.[9]

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[8] Arizona Revised Statutes § 20-444A.

Although the respondent has contended that provisions in the Arizona Insurance Code may be broad enough to cover misleading financial statements in proxy solicitations (Br. in Opp. 6), the provisions to which respondent has referred are directed toward unfair practices and frauds in the transaction of an insurance business. The sections which respondent has cited appear in a chapter of the Arizona Revised Statutes entitled, "Transaction of Insurance Business," and in an article entitled, "Unfair Practices and Frauds," under captions such as "Misrepresentations and false advertising of policies," "False or deceptive advertising of insurance or status as insurer," and "False financial statements or records." Arizona Revised Statutes §§ 20-441 to 20-447. There is nothing to indicate that either these provisions or those relating to mergers in the Insurance Code (Arizona Revised Statutes § 20-731), the latter of which are not a part of Arizona's "Little McCarran Act," give the Director of Insurance jurisdiction to determine whether full disclosure has been made in connection with the solicitation of proxies.

[9] For example, the purpose specified in the preamble to the Securities Act of 1933 is: "To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." 48 Stat. 74. Section 2

In enacting the securities laws, Congress relied on the fact that court decisions had treated securities themselves as subjects of interstate commerce. A *Study of the Economic and Legal Aspects of the Proposed Federal Securities Act*, prepared by the Department of Commerce and set forth in an Appendix to the Senate Committee Hearings, quoted from *Alabama & N. O. Transportation Co.* v. *Doyle*, 210 Fed. 173, 182 (E.D. Mich):[10]

> "We cannot doubt that stocks and bonds are now the subject of interstate commerce, and that shipments and sales of them, between the states, are interstate commerce."

In addition, the postal powers were relied upon as a basis for applying the federal statutes to securities transactions, such as those here, which involved the use of the mails. The very provision in question here, Section 10(b) of the Securities Exchange Act, has as its jurisdictional base "the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange".

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of the Securities Exchange Act specifically notes that not all securities transactions dealt with by that Act are those of issuers engaged in interstate commerce: "Such transactions * * * (c) involve *in large part* the securities of issuers engaged in interstate commerce" (emphasis supplied). 15 U.S.C. 78b.

[10] Hearings Before the Committee on Banking and Currency on S. 875, a Bill to Provide for the Furnishing of Information and the Supervision of Traffic in Investment Securities in Interstate Commerce, 73d Cong., 1st Sess. 329, 330 (1933). The Study also quoted from *Bracey* v. *Darst*, 218 Fed. 482, 495 (N.D. West Va.): "We do not think it can longer be questioned that stocks, bonds, debentures, and other securities are subject-matters of interstate commerce." *Ibid.*

Hence, from the outset, the federal securities laws were drafted with a breadth that embraced transactions by insurance companies or others in securities of insurance companies as well as other businesses—regardless[9] of whether transactions in insurance *policies* were considered subject to congressional regulation under the Commerce Clause (see point I.B, *infra*). That Congress recognized and intended this result is reflected on the face of the statutes themselves, not only in their broad definition of "security" (see *supra*, p. 11) but also in the exemption provisions explicitly dealing with the subject of insurance.

The Securities Act of 1933 provided an exemption in Section 3(a)(8), 15 U.S.C. 77c(a)(8), for an "insurance or endowment policy or annuity contract, issued by a corporation subject to the supervision of the insurance commissioner * * *." This exemption was incorporated by reference in Section 302(a)(4) of the Trust Indenture Act of 1939, as amended, 15 U.S.C. 77ddd(a)(4). Section 3(c)(3) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(3), excepted from the definition of an investment company "[a]ny * * * insurance company * * *." Finally, Section 203(b)(2) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(b)(2), excepted from the requirement of registration with the Securities and

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[9] This exemption was to make "clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the act. The insurance policy and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes." H.R. Rep. No. 85, 73d Cong., 1st Sess. 15 (1933).

Exchange Commission "any investment adviser whose only clients are * * * insurance companies."

Except to the limited extent set forth above, Congress did not exempt insurance companies or their securities from the federal securities laws. Accordingly, both prior to this Court's decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, and subsequent to the enactment of the McCarran-Ferguson Act, issues of insurance companies' securities were registered under Section 6 of the Securities Act of 1933, 15 U.S.C. 77f;[11] the securities of insurance companies listed on national exchanges were registered with the Commission under Section 12 of the Securities Exchange Act of 1934, 15 U.S.C. 78*l*;[12] persons who buy and sell insurance companies' securities were registered under Section 15(b) of the Securities Exchange Act, 15 U.S.C. 78*o*(b);[13] invest-

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[11] See, *e.g.*, First Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1935, p. 77; Registration Statement under the Securities Act of 1933 filed by National Life and Casualty Insurance Company with the Securities and Exchange Commission on September 28, 1953 (File No. 2-10488). Producers Life Insurance Company has filed the following notification of offerings of securities pursuant to Regulation A under the Securities Act of 1933: File No. 24SF-1137 (filed May 11, 1950), File No. 24SF-1711 (filed January 20, 1953) and File No. 24SR-2820 (filed June 5, 1956).

[12] *Infra* at p. 28.

[13] The following brokers and dealers, who are registered with the Securities and Exchange Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934, hold themselves out as specialists in insurance company securities: [illegible] Company (File No. [illegible]); [illegible] (File No. [illegible]) [illegible] Company) (File No. 8-[illegible]). See Security Dealers of North America (1956 ed.).

ment companies with portfolios consisting of insurance companies' securities were registered under Section 8 of the Investment Company Act, 15 U.S.C. 80a-8;[18] and persons selling insurance companies' securities in violation of anti-fraud provisions of the securities acts were enjoined or convicted or their registrations as broker-dealers were revoked.[19]

B. THE MCCARRAN-FERGUSON ACT WAS CONCERNED ONLY WITH THE POSSIBLE EFFECTS OF THIS COURT'S DECISION IN UNITED STATES V. SOUTH-EASTERN UNDERWRITERS ASSOCIATION ON STATE REGULATION OF TRANSACTIONS IN INSURANCE POLICIES AND RELATED BUSINESS ACTIVITIES

Historically, such matters as the chartering and licensing of insurance companies; insurance rates; the content, form and issuance of insurance policies; advertising and sales practices in insurance; the maintenance of proper reserves; and the prevention of un-

[18] *E.g.*, Life Insurance Investors, Inc. (File No. 811-662); Insurance and Bank Stock Fund, Inc. (File No. 811-896); Insurance Investors Fund, Inc. (File No. 811-759); Life Insurance Stock Fund, Inc. (File No. 811-669).

[19] See, *e.g.*, Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1939, p. 250, respecting transactions in stock of Suwanee Life Insurance Company; Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941, p. 338, respecting transactions in stock of Texas Mutual Reserve Life Ins. Co.; Sixteenth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1950, p. 207, respecting transactions in stock of Co-op Insurance Co.; Twenty-Fourth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1958, p. 231, respecting transactions in stock of Great Fidelity Life Insurance Co.; Twenty-Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1959, p. 270, respecting transactions in stock of American Buyers Insurance Co. and Unity Insurance Co.

fair practices by insurance companies in dealing with their policy holders have been regulated by the States." The constitutional power of the federal government to regulate the business of insurance had long been subject to serious doubt under the doctrine of *Paul* v. *Virginia*, 8 Wall. 168, 183, where the Court said:

> Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. * * *

In *United States* v. *South-Eastern Underwriters Association*, 322 U.S. 533, a case involving the application of the Sherman Act to fire insurance premium rates fixed by agreement, it was recognized that, "In all cases in which the Court has relied upon the proposition that 'the business of insurance is not commerce,' its attention was focused on the validity of state statutes—the extent to which the Commerce Clause automatically deprived states of the power to regulate the insurance business." *Id.* at 544. Because "legal formulae devised to uphold state power cannot uncritically be accepted as trustworthy guides to determine Congressional power under the Commerce Clause"[10] (*id.* at 545), this Court held that the doctrine of *Paul* v. *Virginia* was no bar to its determination that "insurance transactions which stretch across

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[10] Huebner and Black, *Life Insurance* (6th ed. 1964), pp. 620-625.

state lines constitute 'Commerce among the several states' so as to make them subject to regulation by Congress under the Commerce Clause". 322 U.S. at 538–539.

The McCarran-Ferguson Act was passed "in order to make necessary adjustments to this decision." S. Rep. No. 20, 79th Cong., 1st Sess. 1 (1945). See, also, H. Rep. No. 143, 79th Cong., 1st Sess. 2 (1945). The Act's "basic purpose was to allay doubts, thought to have been raised by this Court's decision of the previous year in *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533, as to the continuing power of the States to tax and regulate the business of insurance." *Federal Trade Commission v. Travelers Health Assn.*, 362 U.S. 293, 299. See, also, *Wilburn Boat Co. v. Fireman's Ins. Co.*, 348 U.S. 310, 319; *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429–431. Congress intended to "stabilize the general situation," and this was accomplished in part by "declar[ing] that * * * continued regulation and taxation by the several States of the business of insurance is in the public interest; and * * * by suspending the application of the Sherman and Clayton Acts for approximately two sessions of the State legislatures, so that the States and the Congress may consider legislation during that period." S. Rep. No. 20, 79th Cong., 1st Sess. 2 (1945); H. Rep. No. 143, 79th Cong., 1st Sess. 2, 3 (1945).[24] The objective of pre-

[24] Section 3 of the Act also suspended for a like period the application of the Federal Trade Commission Act and the Robinson-Patman Act to the business of insurance. 15 U.S.C. 1013.

serving the favored position of State regulation of insurance as it had existed prior to the *South-Eastern Underwriters* decision was further effectuated in Section 2(b) of the Act, which provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating [or taxing or imposing a fee upon] the business of insurance, * * * unless such Act specifically relates to the business of insurance * * *." This is the provision at issue here.

1. Because Congress did not define the phrase "the business of insurance" as used throughout the McCarran-Ferguson Act, the meaning of that phrase must be determined by reference to the basic purpose and design of the legislation and the problems with which Congress was concerned. Cf. *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U.S. 119. As already noted, the focus of Congress' attention and concern was this Court's holding in *South-Eastern Underwriters* that interstate sales of insurance policies and business activities related thereto constitute interstate commerce subject to congressional regulation under the Commerce Clause. But the federal securities laws, enacted ten years prior to *South-Eastern Underwriters*, had continuously been applicable to transactions in securities of insurance companies (see *supra*, pp. 13-17)—and such transactions were considered to be no more beyond the reach of congressional power than transactions in securities of other companies. Nothing in the history or language of the McCarran-Ferguson Act indicates any congressional intent to reexamine this previously established federal

regulatory jurisdiction over securities transactions. The Act was wholly a response to the *South-Eastern* decision, in which the phrase "the business of insurance" was prominently used in the Court's opinion (see *supra,* p. 18).

In addressing itself to regulation of "the business of insurance" in that Act, therefore, Congress was referring to those activities of insurance companies which, under the constitutional interpretation prevailing prior to *South-Eastern Underwriters,* had been thought to be immune from federal regulation under the Commerce Clause and thus had been exclusively the subject of State regulation (except as they might collaterally be affected by the exercise of other congressional powers, *e.g.,* in the copyright, tax or postal laws). These included such matters as rates, the content, form and issuance of policies, the maintenance of proper reserves, the prevention of unfair practices in dealing with policyholders (cf. *Federal Trade Commission* v. *National Casualty Co.,* 357 U.S. 560), etc. It was only with respect to those matters—the "business of insurance"—that Congress intended partially to preclude the application of federal legislation and to preserve the favored status of State regulation because it was only in those areas that any threat of interference with settled State practices was posed by the *South-Eastern Underwriters* decision.

2. The *South-Eastern Underwriters* decision posed only two categories of "doubts * * * as to the continuing power of the States to tax and regulate the business of insurance" (*Federal Trade Commission* v. *Travelers Health Assn., supra,* 362 U.S. at 299). One

category resulted from the fact that the Commerce Clause, of its own force, has been held to impose limitations on State regulation and taxation of interstate commerce even when Congress has been silent. Congress addressed itself to those "doubts" in Sections 1 and 2(a) of the McCarran-Ferguson Act. The second category of "doubts" arose from the possibility that Acts of Congress generally applicable to interstate commerce would now be construed to apply to "the business of insurance" and thereby "to invalidate, impair, or supersede" State regulation previously thought to be immune from that threat. This is the question to which the remainder of the Act, including Section 2(b), was addressed.

Plainly, the threat that an Act of Congress might "invalidate, impair, or supersede" State law was posed by the *South-Eastern Underwriters* decision only to the extent that the federal statute would not affect "the business of insurance" but for the holding in that case that such business constitutes interstate commerce. Federal statutes whose effect on "the business of insurance" did not depend on the holding in *South-Eastern Underwriters* were simply outside the range of congressional concern or intention in the enactment of the McCarran-Ferguson Act. This is demonstrated not only by the Act's legislative history (see *supra*, pp. 19-20; *infra*, p. 24), but also by consideration of the Acts of Congress that were particularly specified on the face of the statute and those that were not. Sections 2(b), 3 and 4 of the Act contain special provisions relating to the Sherman Act, Clayton Act, Federal Trade Commission Act, Robin-

son-Patman Act, National Labor Relations Act and Fair Labor Standards Act—all of which seemed applicable to insurance companies only to the extent to which "the business of insurance" was regulable under the Commerce Clause.[19] But no mention was made of numerous federal statutes—such as copyright and patent laws, certain tax laws,[20] counterfeiting laws, postal laws, or the federal securities laws—which do not expressly relate to insurance but which always had been applied to those engaged in the business of insurance without regard to whether that business was considered regulable under the Commerce Clause. It simply would not have occurred to those who enacted the McCarran-Ferguson Act that anyone could think that the Act would, for example, enable a State: (1) to permit an insurance company to infringe a federally granted copyright or patent, or to grant an insurance company similar monopoly rights not authorized by the federal copyright or patent laws (cf. *Sears, Roebuck & Co.* v. *Stiffel Co.*, 376 U.S. 225; *Compco Corporation* v. *Day-Brite Lighting, Inc.*, 376 U.S. 234); (2) to excuse an insurance company from its obligations to pay federal taxes

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[19] The only arguable exception is the Merchant Marine Act, 1920, 41 Stats. 988, 46 U.S.C. 885 (specified in Section 4 of the McCarran-Ferguson Act). An exemption from the antitrust laws was provided in Section 29(b) of that Act for associations of marine insurance companies, and the Act therefore may have been expressly excepted from the McCarran-Ferguson Act to make clear that this exemption would continue to apply even after the McCarran-Ferguson Act moratorium on the antitrust laws had expired.

[20] See, *e.g.*, 26 U.S.C. 4251 *et. seq.* (Telegraph and Telephone Tax Act); 26 U.S.C. 3111 (social security tax).

in order to increase the company's reserves; (3) to authorize an insurance company to print counterfeit money in order to pay insurance claims that it is otherwise unable to meet; or (4) to allow an insurance company to use the mails to defraud stockholders in connection with the purchase or sale of securities. Any of these results would be directly contrary to the intention clearly expressed in the House Report on the Bill as enacted (H. Rep. No. 143, 79th Cong., 1st Sess. 3):

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *South-eastern Underwriters Association* case. * * *

This language in the House Report was relied upon as "decisive" in an opinion joined by four members of this Court which adopted the interpretation of the McCarran-Ferguson Act we now advocate. *Maryland Casualty Co.* v. *Cushing*, 347 U.S. 409, 413 (opinion of Mr. Justice Frankfurter). In a passage which a majority of this Court later specifically cited with apparent approval and endorsement (*Federal Trade Commission* v. *Travelers Health Assn., supra*, 362 U.S. at 299), that opinion stated that "even the most cursory reading of the legislative history of this enactment [McCarran-Ferguson Act] makes it clear that its exclusive purpose was to counteract any adverse effect that this Court's decision in *United States* v. *South-Eastern Underwriters Association*, 322 U.S.

533, might be found to have on State regulation of insurance." (347 U.S. at 413.) Because the issue in *Cushing* was "not touched by the *South-Eastern Underwriters* case", the McCarran-Ferguson Act was deemed "not relevant" (*ibid.*).[21] As we have shown above, the question of the applicability of the federal securities laws to transactions in insurance company securities was likewise "not touched by the *South-Eastern Underwriters* case."[22]

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[21] There was more reason in *Cushing* than in the present case to refer to the policy underlying the McCarran-Ferguson Act for guidance in construing a federal statute so as to avoid a direct conflict with State law. See 347 U.S. at 432–438 (dissenting opinion of Mr. Justice Black); cf. 347 U.S. at 423–427 (concurring opinion of Mr. Justice Clark). Section 10(b) of the Securities Exchange Act of 1934 does not conflict with the Arizona insurance law, but is supplementary and collateral to it. The Commission's suit in no way sought to alter or modify any of the requirements that State law imposes upon insurance companies; its objective was solely to prevent misrepresentations in securities transactions and to obtain effective relief for shareholders who had been injured thereby. Surely this would not "invalidate, impair, or supersede" State insurance regulation within the meaning of Section 2(b) of the McCarran-Ferguson Act. As stated in the text above, however, we contend more broadly that a proper interpretation of the McCarran-Ferguson Act would preclude the possibility that a State, by any structuring of its insurance law, could immunize those dealing in securities of insurance companies from the applicability of the antifraud provisions of the federal securities laws.

[22] Indeed, in *United States* v. *Sylvanus*, 192 F. 2d 96 (C.A. 7), *certiorari denied*, 342 U.S. 943, the court upheld, in a situation where, as here, the use of the mails provided the jurisdictional basis for the application of the statute, a conviction for mail fraud committed in connection with the sale of accident and sickness insurance policies. The argument that the indictment was barred by the McCarran-Ferguson Act was specifically rejected (192 F. 2d at 100): "[W]e believe that it can not properly be said that this indictment has to do with the regula-

3. The interpretation of the McCarran-Ferguson Act advocated herein has already been adopted implicitly by this Court in the context of securities regulation in *Securities and Exchange Commission* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, where, as the opinion points out, the respondent was "in the main * * * an insurance company exempt from the requirements of the Investment Company Act" (*id.* at 212). It had been urged in that case that the McCarran-Ferguson Act barred the application of the Securities Act of 1933 to the transactions in variable annuity contracts there involved.[25] In ruling that the variable annuities were "securities" subject to the 1933 Act, this Court necessarily determined that the McCarran-Ferguson Act did not bar the application of the federal securities laws to transactions in securities of insurance companies.

The respondent in the *United Benefit* case was supervised by the Director of Insurance of the State of Nebraska and by insurance commissioners of other States in which it was authorized to do business.[26] Similarly, in *Securities and Exchange Commission* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65, 94, as pointed out in the dissenting opinion, the companies there involved were "organized under the Life Insur-

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tion of [the] insurance business in Illinois. Rather it has to do with the question of whether defendants have used the mails in pursuance of a scheme so to manipulate their authorized regulated business in Illinois as to result in fraudulent deception of its prospective policy holders."

[25] See brief for respondent, No. 223, 1966 Term, pp. 25, 42-43, and the district court opinion in *Securities and Exchange Commission* v. *United Benefit Life Insurance Company*, CCH Fed. Sec. L. Rep. ¶91,508 (D.D.C., March 22, 1965).

ance Act of the District of Columbia, * * * and [were] subject to regulation by the Superintendent of Insurance of the District of Columbia, who * * * approved the annuity policies written by them." Because this Court found the variable annuities sold were basically securities, it held that their sale was subject to the Securities Act of 1933 and that the companies issuing such securities, as well, were subject to the Investment Company Act of 1940, notwithstanding the supervision of the State[illegible] insurance authorities and the respondents' contentions that they were immunized from federal regulation by the McCarran-Ferguson Act (see 359 U.S. at 67–68).

4. Congress, as well as this Court, has indicated its understanding that the applicability of the federal securities laws to transactions in securities of insurance companies was unimpaired by the McCarran-Ferguson Act. When amendments to the federal securities laws were being considered in 1963, the Commission filed a statement with the House Committee which summarized the relationship of insurance companies with the federal securities laws up to that time, as follows:[illegible]

> Historically, insurance companies have never been exempted from either the Securities Act of 1933 or the Securities Exchange Act of 1934. Under the Securities Act of 1933, an insurance company distributing its securities to the public must file a registration statement with the Com-

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[illegible] The District of Columbia is a "State" within the meaning of the McCarran-Ferguson Act (15 U.S.C. 1015).

[illegible] Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 6789, H.R. 6793, S. 1642, 88th Cong., 1st Sess. 176 (1963).

mission and comply with all of the provisions of that act, in the same manner as any industrial company. Likewise, under the Securities Exchange Act, an insurance company listing a security on a national securities exchange must comply with all of the provisions of that act applicable to exchange-listed companies. Presently two insurance companies have a security so listed and comply with those provisions of the act. Moreover, section 15(d) of the Exchange Act, added to that act in 1936, is fully applicable to insurance companies. That section requires an issuer distributing its securities to the public under a Securities Act registration statement to file periodic financial and other reports with the Commission if the value of the securities offered plus the value of all other outstanding securities of the class offered exceeds $2 million. Under section 15(d), approximately 148 insurance companies, including about 96 life insurance companies, file periodic reports with the Commission * * *.

When the amendments were reported out of committee in the course of their adoption, the Senate Committee on Banking and Currency specifically stated, "Stock insurance companies are presently subject to the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.""

The holding of the court below to the contrary is unwarranted.

S. Rep. No. 379, 88th Cong., 1st Sess. 36 (1963). Although the views of the Congress that enacted the 1964 legislation "provide no controlling basis from which to infer the purposes of an earlier Congress" that passed the McCarran-Ferguson Act, such views nevertheless are "pertinent." See *Haynes* v. *United States*, 390 U.S. 85, 87–88, n. 4.

II

THE 1964 AMENDMENTS TO THE FEDERAL SECURITIES LAWS ARE CONSISTENT WITH THE COMMISSION'S CONTENTIONS IN THIS CASE

In 1964, Congress enacted amendments to the Securities Exchange Act, to take effect in 1966, which require registration of the equity securities of the larger over-the-counter companies and extend reporting, proxy, and insider-trading provisions to such companies. Securities Acts Amendments of 1964, 78 Stat. 565. The amendments except from such extended coverage, however, securities of insurance companies that are, *inter alia*, subject to specified regulation under State law that "conforms to that prescribed by the National Association of Insurance Commissioners."[28] Congress determined that as to these matters, State insurance commissioners should "be given an opportunity to demonstrate their ability effectively to protect the investors as well as the policyholders."[29] These exemptions are limited solely to the expanded application of the requirements relating to periodic reports, proxies, and insider-trading and do not purport to affect other requirements imposed by the various federal securities laws, such as the antifraud prohibitions of Section 10(b) of the Securities Exchange Act. Section 10(b) is, of course, not limited to proxy solicitations but comprehends all fraud committed in the purchase or sale of securities, and the

[28] Securities Exchange Act, Section 12(g)(2)(G)(ii), 15 U.S.C. 78*l*(g)(2)(G)(ii).

[29] H. Rep. No. 1418, 88th Cong., 2d Sess. 10 (1964).

jurisdiction of the State regulatory authorities over proxy solicitations would not provide any protection in this broader area for insurance company investors.

Prior to the 1964 amendments, as we have shown (*supra*, pp. 16–17, 27–28), it was regarded as settled that the antifraud provisions, which apply alike to listed and unlisted securities, covered insurance company securities. Because the amendments in no way narrowed the scope of the Securities Exchange Act of 1934, they did not transfer to the States any of the functions previously performed by the Commission. On the contrary, Congress extended other provisions of the Act to cover some unlisted securities, but excepted from this extension of coverage securities of insurance companies subject to comparable regulation by the States. As far as those securities are concerned, therefore, the reach of the Securities Exchange Act of 1934 can be no narrower after the 1964 amendments than it was before.

There are fundamental distinctions between the antifraud provisions of Section 10(b) and the recently extended proxy provisions of Section 14 (15 U.S.C. 78n). Section 10(b) is directed against fraud in connection with the purchase or sale of securities, whether or not such fraud involves a proxy solicitation. Section 14 applies to all proxy solicitations (not exempted), whether or not they are related to any purchase, sale or exchange of securities. Because proxies are utilized in connection with many managerial activities of a company—some of which might be considered a part of "the business of insurance" as the term was used in the McCarran-Ferguson Act

(see *supra*, pp. 20-21)—there is no inconsistency between Congress' granting of the insurance exemption from the extension of general proxy regulations in 1964 and the continuation of the Commission's longstanding authority under Section 10(b) to protect all investors against all forms of fraud in the specific area of purchases and sales of securities.[30]

[30] There is also no inconsistency between the Commission's position in the present case and the fact that in 1964 the Commission listed "mergers" as among the examples of inadequate proxy controls over insurance companies (Br. in Opp. 12). Even though the antifraud provisions of Section 10(b) confer a jurisdiction that is in many respects broader than mere jurisdiction to regulate proxy solicitations, proxy regulation can supplement the Section 10(b) jurisdiction in at least two ways: by conferring more definite authority to require affirmative disclosures in certain situations, and by providing a means of regulating mergers that may be consummated in the form of a purchase of assets without any exchange of securities.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed and the case remanded for further proceedings.[31]

Respectfully submitted.

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[31] The district court held that the relief the Commission sought (see *supra*, pp. 6–7) was not authorized by the statute and would be inappropriate (App. 144). The court of appeals did not decide the question. If this Court reverses on the McCarran-Ferguson Act issue, it should remand for the court of appeals to consider the relief question and the other issues tendered by the parties that it did not decide. Cf. *Federal Trade Commission* v. *Borden Co.*, 383 U.S. 637, 639.